- Dow Jones Reprints: This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers, use the Order Reprints tool at the bottom of any article or visit www.djreprints.com

  See a sample reprint in PDF format. Order a reprint of this article now

- THE WALL STREET JOURNAL.
  WSJ.com

- AUGUST 29, 2009

# Halting Recovery Divides America in Two

## By CARI TUNA, LIZ RAPPAPORT and JULIE JARGON

The U.S. recovery is a tale of two economies.

At one extreme of Corporate America is a cadre of companies and banks, mostly big, united by an enviable access to credit. At the other end are firms, chiefly small, with slumping sales that can't borrow or are facing stiff terms to do so.

On Main Street, there are consumers with rock-solid jobs -- but also legions of debt-strapped individuals struggling to keep their noses above water.

This split helps explain the patchiness of the recovery that appears to be taking hold after the worst recession in a half-century.

View Full Image

*Carlos Javier Ortiz for The Wall Street Journal by*

RED AND BLACK: Cynthia Jamison, chief financial officer of irrigation-probe maker AquaSpy Inc., says her 'cash poor' firm has had to cut staff.

Panera Bread, a St. Louis-based national chain of more than 1,400 cafes, is a rare winner in its industry. With more than $100 million in cash and no debt, it is demanding, and getting, cut-rate leases from landlords. Panera's occupancy costs have come down 10% to 20% since last year. It is hiring and expanding into spaces formerly occupied by Blockbusters and Bennigan's.

"For us, this is the best of times," says Ron Shaich, its chief executive. "Cash is king and this is a buyer's market."

Business is tougher for Panera franchisees. They can still borrow -- but at a price. Mike Hamra, who owns 47 Panera restaurants in the Boston and Chicago areas, says he is paying a full percentage point more on his loans than he paid last fall. "Banks are not throwing money at us," Mr. Hamra says.

AquaSpy Inc., a maker of high-tech irrigation gear for farmers, has similar headaches. Its customers want to see stable production before placing big orders, says Cynthia Jamison, the acting chief financial officer, while some suppliers demand up-front payment. These are "the bumps in the road that are driven by being cash-poor," she says. AquaSpy's staff has shriveled to 26 from 80 the past few years.

View Full Image

*Panera Bread*

Gregg Godfrey, Ron Shaich and Mike Vasil of Panera Bread have plenty of credit and are thriving; 'For us, this is the best of times,' says CEO Shaich.

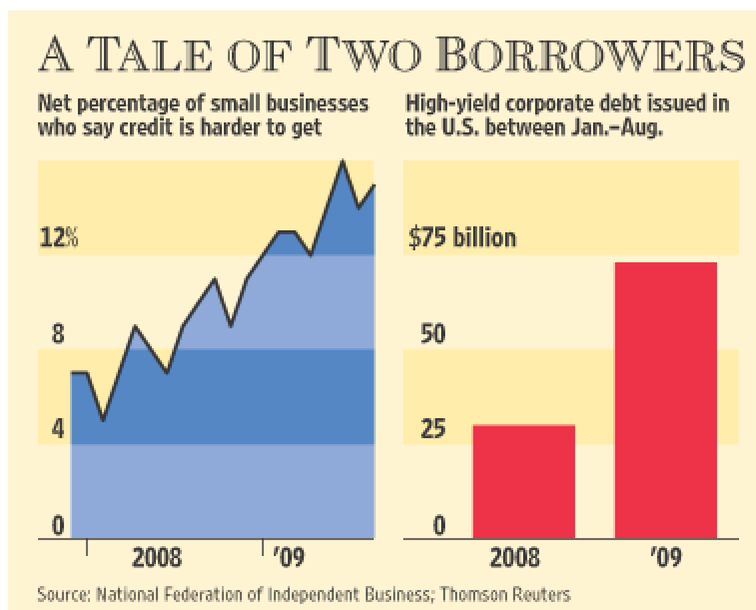
The split between companies that can borrow and those that can't shows the extent to which any recovery depends on reviving the nation's ailing banks and squeamish credit markets. Until that happens, the vigor of the economy will remain in doubt.

"If you're not making money, you need to borrow money," says John Graham, a finance professor at Duke University's Fuqua School of Business. But "you need to be creditworthy in order to borrow, and if you're not making money, you're creditworthiness isn't very strong."

Mr. Graham, who oversees a quarterly survey of CFOs, says more companies are doing better than they were a few months ago. Still, he estimates, one in four is in "dire straights due to lack of profits combined with not being able to borrow."

Companies big enough to bypass banks and go directly to capital markets are finding a warmer reception. That's because the markets are showing more willingness to make risky loans: In January, only eight of the 56 companies that sold bonds were rated below-investment-grade, or "junk," according to Dealogic. In August, by contrast, 24 of the 60 deals had junk ratings.

Since the start of the year, companies have been increasingly turning to the bond markets to raise money. Through August thus far, companies have issued $395.4 billion in bonds over 512 deals, according to Dealogic, a healthy increase from the second half of last year when the markets went months with fewer offerings and less than a handful of junk bond deals.




One test of a recession's end is evidence that companies are willing to take risks buying other companies. Here, too, "there is a bifurcation of the market," says Jeff Raich, head of mergers and acquisitions at investment bankers Moelis & Co. "Once you see lower-credit-quality companies get access to loans, that will be a sign the capital markets are turning."

One hopeful sign is the recent $3.1 billion purchase by Warner Chilcott Ltd. of Procter & Gamble's pharmaceutical business. The buyer managed to get a $4 billion leveraged loan -- a loan to an already highly indebted borrower -- to do the deal and refinance the debt.

"If it was a smaller company, that deal would have been more difficult to finance," Mr. Raich says.

But many firms dependent on banks are finding credit tougher to come by. In the Federal Reserve's latest survey of senior loan officers, conducted in July and released in mid-August,

about 35% of banks said they had raised lending standards since April for nearly all business borrowers, regardless of size. The rest left them unchanged, which is to say much tougher than a couple of years ago. Most banks said they are charging business customers more, relative to the banks' cost of funds.

"We are absolutely managing and making decisions based on ... our relationship with the bank," says Bob Klotz, CEO of Bayside Solutions Inc., a temporary-staffing firm with a multimillion-dollar credit line from a "major bank." The bank raised rates about three months ago and has increased the financial reporting it requires "tenfold" compared to last year.

That has prompted the Pleasanton, Calif., firm to turn away less-creditworthy clients -- including other small businesses -- which are more likely to file for bankruptcy or fall behind on payments. "We're not in a position where we can take that risk," he says.

Mr. Klotz estimates that Fortune 1000 companies represent 80% of his business now, up from 60% previously.

View Full Image

*T.C. Worley for The Wall Street Journal*

David Dalquist, owner of Nordic Ware, outside his company's newest building in St. Louis Park, Minnesota.

As sales slowed and cash flows tightened earlier this year, Bayside laid off 15 employees (mostly recruiters and salespeople) and abandoned low-margin business lines, like placements for light-industrial workers and back-office staff, where competition from temporary-staffing behemoths Manpower Inc. and Adecco SA is fiercer, says Mr. Klotz. He now employs about 60 full-time staffers.

"We've been put through the wringer," says Mr. Klotz. The company is doing "a lot more due diligence" on every potential customer.

Northland Aluminum Products Inc. in Minneapolis, maker of Bundt pans and Nordic Ware, played it safe during the boom times and kept a rainy-day fund. So when the recession struck, it decided to use it as a chance to expand. It's in the midst of a $5 million project to increase its capacity by 40% to 50%. "I went out in October looking for money, and I had banks fighting over the deal," says David Dalquist, Northland's chief executive. He says four banks made proposals to him.

"We lived within our means and conserved ourselves," Mr. Dalquist says of the privately held company. "Now we're in a position to take advantage of these difficult times."

He says business is up 8% this year, mainly because Northland is grabbing market share from struggling rivals. Meantime, the construction bust means the plant expansion cost about 25% less than it might have a few years ago. "There are a lot of hungry contractors," Mr. Dalquist says.

In the business of finance itself, a divide between early winners and others appears to be opening up as well. Many of the nation's biggest financial institutions, benefiting from federal-

government backing, have been able to raise equity and debt from private investors. Some large money-management companies such as BlackRock Inc. are profiting by helping the Treasury with the clean-up from the burst bubble.

Some of the nation's largest banks could, in fact, emerge from the crisis stronger than they entered it. While they have suffered huge losses on complex financial products, and are still facing mounting loan defaults, they were stabilized with tens of billions of dollars of taxpayer money. In the second quarter, the seven largest commercial banks earned more than $14 billion, even as thousands of smaller banks were in the red.

Big lenders are currently enjoying an advantage in their "cost of funds" -- the raw material of a bank, which is in the business of borrowing cheaply and lending at a higher rate. The handful of banks with more than $10 billion in assets were paying 1.18% to borrow money in the second quarter, the FDIC said in data issued Thursday. By contrast, banks with $100 million and $1 billion in assets were paying 1.97%, a big difference in a business where tenths of a percentage point translates into millions of dollars in profits.

Usually it is the other way around -- small banks pay less. But large banks have always obtained a much larger share of their funding from sources other than deposits, such as borrowing short-term from other banks at the federal funds rate, which is largely set by the Federal Reserve. With the Fed holding that rate near zero, large banks are benefiting more than smaller banks.

Some big banks, like J.P. Morgan Chase & Co., U.S. Bancorp, PNC Financial Services Group Inc. and BB&T Corp., have cemented their megabank status by gobbling up rivals that were seized by regulators. As of June 30 the three largest banks -- Bank of America, Wells Fargo, and J.P.Morgan -- collectively had $2.3 trillion in domestic deposits, or 31% of the industry total, according to the Federal Deposit Insurance Corp. Two years earlier, the top three had only 20% of the industry total.

Working for a big bank doesn't necessarily offer much job security, however. At the height of the boom, Andrea Caroline, 27 years old, was pulling down $160,000 a year at J.P. Morgan Chase's subprime-mortgage division as an account executive. Then the market collapsed. She was laid off in March 2008.

After sending 300 copies of her résumé, she's still looking for a new job. She says that the word "subprime" on her résumé has conjured suspicion among prospective employers. "They think I was stealing money. And I have to say: 'Look, I wasn't doing anything personally. All I'm asking for is another opportunity.' "

Ms. Caroline moved in with her parents to save on rent, and she turned in her BMW as a voluntary repossession, unable to keep up the $800-a-month payments.

While Ms. Caroline is an individual using plastic to try to get by, credit-card debt is also a tool famously used by small businesses to finance themselves. There's bad news here as well, since card issuers are clamping down on lending as well.

In the most recent Fed survey of senior loan officers, about one in four banks said they had decreased the limits on business credit cards over the past three years; only one of 33 banks had increased. Most bankers said their standards for credit-card loans to their best customers would remain tighter than normal into 2011 or beyond.

Overall, as is often the case after a rash of banking problems, smaller banks accuse government regulators of over-reaction, while regulators say the bankers are reluctant to fess up to their mistakes.

It is easier for regulators to go after smaller banks, says Robert Hartheimer, a Washington, D.C., banking consultant and former head of the FDIC's Division of Resolutions. "Small banks' loans tend to be concentrated in the hardest-hit sectors of the economy," such as local real-estate lending, he points out.

Whatever the cause, would-be borrowers feel the pain. Riverview Community Bank of Vancouver, Wash., which serves the Portland, Ore., region, has cut back lending in the past year under pressure from regulators to increase its capital levels -- which means either raising new capital, or shrinking its assets. The bank's loan portfolio declined 24% this year from the first quarter to the second, according to FDIC data.

The bank isn't renewing loans when they come due, said Ronald Wysaske, its president. He expects the bank to remain in a defensive crouch, with little appetite to lend more, for at least another year. "I'd hate to think that it would last longer than that," he says.

*—Tim Aeppel, Jeff McCracken and Mary Pilon contributed to this article.*

**Write to** Cari Tuna at cari.tuna@wsj.com, Liz Rappaport at liz.rappaport@wsj.com and Julie Jargon at julie.jargon@wsj.com

*Printed in The Wall Street Journal, page A1*

Copyright 2009 Dow Jones & Company, Inc. All Rights Reserved

This copy is for your personal, non-commercial use only. Distribution and use of this material are governed by our Subscriber Agreement and by copyright law. For non-personal use or to order multiple copies, please contact Dow Jones Reprints at 1-800-843-0008 or visit

www.djreprints.com